EXHIBIT E

Transcript at Oral Argument, *Sec. Investor Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC (In re Madoff Sec.)*, No. 12 Misc. 115 (JSR) (S.D.N.Y. Oct. 12, 2012), ECF No. 401

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK
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SECURITIES INVESTOR PROTECTION CORPORATION, IRVING H. PICARD,

Plaintiffs,

v. 12 MC 115 (JSR)

BERNARD L. MADOFF INVESTMENT SECURITIES LLC, et al.,

Conference

Defendants.

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New York, N.Y.
October 12, 2012
4:40 p.m.

Before:

HON. JED S. RAKOFF

District Judge

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(Case called)

THE COURT: I'm going to try to keep this as short as possible because I don't think the economy can stand having to pay for all the lawyers in this room. This, unlike some of the issues that have come before the Court involving the Madoff matters, is one that the Court has previously dealt with. Between that and the extensive briefing, I have reached some tentative conclusions, although I will make no final conclusions until I've heard oral argument and issued a written opinion.

My tentative conclusion is that the standard that the trustee must meet to establish lack of good faith under a willful blindness approach, as opposed to an actual intent approach, is that the defendant must subjectively believe that there is a high probability that a fact exists and the defendant must then consciously turn away or otherwise take a deliberate step or decision to avoid learning of that fact. Essentially, with a very slight massaging, the test set forth in Global-Tech Appliances v. SEB, 131 S.Ct. 2060, 2070, a 2011 decision of the Supreme Court.

I am also of the view that in an action brought under section 550, the burden is on the trustee to -- I'm sorry. I think I'm overstating where my head is at on the second thing. I'm not sure whether the burden of establishing good faith is on the defendant or the burden of establishing lack of good

faith is on the trustee. So I am anxious to hear argument on that issue, much more anxious to hear argument on that issue than on the standard. But I am tentatively of the view that it may vary as between a claim brought under 548 and a claim brought under 550. That's what I was about to try to say but didn't say very well.

Given all that, I think I should hear first from the trustee.

MR. WARSHAVSKY: Thank you, your Honor. I'm trying to digest your tentative ruling.

THE COURT: The standard is one you have heard before from this Court.

MR. WARSHAVSKY: It is in part.

THE COURT: It's been the standard in securities law from time immemorial. It is also functionally equivalent to the standard for recklessness, which has been the law of most states and England since about 1700, but of course only I would remember that.

MR. WARSHAVSKY: Fair enough. I guess where I'll start is maybe on both prongs of what your tentative ruling goes to in terms of what the standard is and where the burden is. I'd like to take a step back maybe to address both. In doing so what I would like to do is actually focus on the trustee's claim. When I was reading through the briefing I think that gets a little lost, so I thought about it in a

slightly different way.

The trustee's claim isn't one for damages. The trustee's claim against these defendants is actually over who has greater rights to a particular transfer: Is it the trustee or is it the defendants? That's where I know I have spoken before about the bona fide purchaser for value. I think that's where that test always comes in. I think that's why we see it codified in the bankruptcy code.

Ultimately, the bankruptcy code starts with the presumption that it is property of the estate. The fight is always between the bankruptcy estate and the defendants, the transferee. The defendants can keep that transfer if they show good faith and if they show value. I don't think anybody disputes that that is the test in a typical bankruptcy, certainly not for an initial transfer in any event.

Your question here, the question that you certified, was whether SIPA or the securities laws alter those burdens.

THE COURT: And/or the test.

MR. WARSHAVSKY: And/or the test. Our answer is we don't think it does. I am sure that is no surprise. I'll take those one at a time.

Number one, I'll go to simply the plain language, which I know your Honor has quoted to us and we have tried to hew very close to that. There is nothing in SIPA itself other than incorporation of the bankruptcy code. We have discussed

that. It is certainly in our papers. All SIPA itself does is vest the trustee with the powers that a bankruptcy trustee would otherwise have.

Then the question is whether or not the securities laws more generally would alter the test. Your Honor pointed to the recklessness standard. I think if you read through the defendants' papers and go through all the analogies, and they certainly advocate for the higher standard and for the burden shifting, each one of those cases is a case about damages.

I think it is important, whether it is a 10b-5 case, or a case about a control person liability. I think there are a few different examples defendants gave, but what we don't have is what is essentially here, which is simply a contest over who has greater rights.

In those types of cases there is no presumption that a defendant owes damages. I think that is the difference. That's the reason for a heightened standard. Here there is the presumption which is baked into the bankruptcy code that this is property of the bankruptcy estate.

So, when the defendants point to the willful blindness standard in those cases --

THE COURT: Good faith, forgetting now about the securities law, that's a term that goes back well prior to the bankruptcy code, well prior to the founding of this country. It comes ultimately out of what used to be taught in first year

property, medieval cases, all of which turned on mental states, not on sort of objective situations devoid of mental state, and dealt with the problem that has always been a problem in the law from day one, which is when you have someone who takes, like a stolen good, but he gets it in good faith. The thief sells it to the purchaser and the purchaser doesn't know it's a thief. The common law resolved that by saying if it's a good faith purchaser, then you get to keep it.

You are right that many of the presumptions of the common law were changed by the enactment of the bankruptcy code. But I don't know that that trumps, while we are dealing here in a mixed securities and bankruptcy situation, what is the classic view of good faith, which is a subjective view rather than the objective view you're talking about.

MR. WARSHAVSKY: I know through the papers there is discussion about subjective and objective, and I think there are elements of both in each test. Ultimately, I think the test you just articulated, you said good faith and I used the term bona fide purchaser for value. But I agree I think that is the test that we have espoused as well. Is it for good faith and is it for value.

Good faith, though, I think is different from knowledge, especially when we go to the issue of -- I'm sorry. I lost my train of thought.

THE COURT: Take your time.

MR. WARSHAVSKY: When we talk about willful blindness, which I think is the standard which has been espoused, I was looking through some of the willful blindness. There is a whole taxonomy there which I think is built around getting to knowledge. Ultimately, willful blindness, if you start from the model penal code -- and the case I saw went actually to 1860, not to the 1700s -- essentially was about sticking one's head in the sand, and that was a way for a plaintiff or the government to actually show knowledge. Good faith I think is a slightly lower standard.

There certainly are subjective elements to a good faith test. Certainly in each of these cases what we have alleged has been what these defendants saw. But ultimately whether or not the defendant acted in good faith should be measured against what a reasonably prudent person would do in the defendants' shoes.

It is not criminal. And I want to respond to your analogy to the security law as well. Another analogy that I came up with as we were coming down here, and I'm sorry to give a hypothetical but I think it helps you with my point, so if you would indulge me.

THE COURT: Go ahead.

MR. WARSHAVSKY: If Bernard Madoff had five shares of the old stock certificates of IBM and went through the exact same scenario that you just indicated, where perhaps he gave

them to somebody who didn't pay proper value or perhaps somebody did pay proper value for them, or maybe his wife did it and maybe it was somebody he knew, maybe it wasn't. He knew about the impending bankruptcy.

The bankruptcy law is simply about determining who has the greater rights. So, you're right, what he would have to show, what that defendant would have to show, is that he took with good faith and he provided value. I don't think that defense would change whether it was a security or deed to a property. I know there are special rules about cash per se, but if it was a bag of cash or a diamond, it would all be related to that test. It would be good faith and for value.

The way we would look at good faith is whether or not a reasonable person in that defendant's shoes would understand that there was something untoward about the transaction.

THE COURT: I can live with everything you just said until you get to that last point. Why is that what good faith means? To continue your hypothetical, for value he gives a share of IBM to an 80-year-old crippled widow who, because she spent her entire life working hard as a cleaning lady for the benefit of her children, all of whom went to Harvard, has never achieved any financial sophistication whatsoever. And the world's greatest lie detector tests all show that she took subjectively in good faith.

She paid her value, she had absolutely no reason to

know that these were stolen goods, and she got her share of IBM. You want to take it away from her because a reasonable person, you say, would have been suspicious or something like that, a negligence type standard.

MR. WARSHAVSKY: No, actually I don't think we would want to take it away from her, because it is a similarly situated --

THE COURT: You think the relevant class is the class of all crippled widows who -- this is going to be an interesting test you're probably getting here.

MR. WARSHAVSKY: I think we always struggle to find out who would be a reasonably prudent person in a defendant's shoes.

THE COURT: If you are defining a defendant's shoes as so individualistic that it only applies to someone who is basically the defendant, the difference between your test and the one that your adversaries are proposing becomes, as a practical matter, very modest indeed.

MR. WARSHAVSKY: I think in some scenarios that could be. I think in scenarios here, where we are dealing with financial transactions, that is not probably not.

THE COURT: Also, on that narrow a test is what you are saying you want achieve, which is an objective test, a reasonable investor type test that can be applied fairly easily across the board without much inquiry into the specific facts

of the case. I thought that was at least implicitly one of the benefits of your test, which would disappear if we narrow it down to what does a reasonable person with less than a high school education, etc.

MR. WARSHAVSKY: I'm trying to think of how to respond. You baked a lot into that. I think the response is that when we're talking about financial transactions, there are certain -- I don't think we have to look to an expert to say what is somebody's precise sophistication, but I think we can look to who the defendant is and what sort of class they are in.

Frankly, the way we have parsed out the world, if you take a look, most investors in BLMIS we did not make these allegations against. The allegations of a lack of good faith, which is the standard we have clung to throughout, we have made against financially sophisticated investors. We think that in measuring their good faith you should measure their actions against what a reasonable sophisticated investor or reasonable financial institution would do when presented with the same indicia of fraud.

As a for instance, I don't know that the woman from your example would understand that BLMIS could not trade on days when the market was closed. I do think that anybody who is represented by the people at this table should know that. And I do think that to the extent they would say, we didn't

know, we should look to measure their conduct in accordance with what people in the industry would know and what would be common knowledge to them. I think that is the objective part of the test.

Certainly they would have to have seen, their account statement would have to show, that BLMIS made the trade on the day the market was closed. They couldn't guess from somebody else's account statement.

THE COURT: Forgive me, but I think we need to hear from some of your adversaries. If the representative from SIPC wants to chime in at this point, I'll hear whatever he has to say.

MR. KELLEY: Yes, your Honor, just briefly. I would like to point out that SIPA relies upon the bankruptcy code both for procedural and for substantive purposes. Courts have recognized that SIPA liquidation is essentially a bankruptcy proceeding. It has the same goals as bankruptcy in that it seeks the ratable distribution of the estate's assets among customers to the extent of readjusting the rights and obligations of those customers.

I, of course, agree with the trustee that even under a SIPA liquidation, you should be referring to the good faith standard that other courts have recognized in bankruptcy proceeding.

(Continued on next page)

MR. KELLEY: (continuing) SIPA relies upon the bankruptcy code, is clear from several provisions of SIPA, but I would like to focus on 78fff-2(c)(3). It specifically provides that whenever customer property is insufficient to pay all customer claims, a SIPA trustee may recovery transfers to the extent they voided or avoidable under Title 11. There are two points I would like to draw from this section.

First of all, it only references voidability under Title 11. It adopts fraudulent conveyance statutes from Title 11 wholesale and to the extent of the bankruptcy code without reference to the securities laws.

Second, for the purposes of such recovery, 2(c)(3) deems the transfer of property shall be deemed to have been property of the debtor. Thus, while the securities laws and state laws and even SIPA itself recognize that broker customers investment and withdrawals are the customer's property. SIPA agrees a legal fiction to modify these rights declaring the property transferred from the debtor shall be treated as the debtor's property in order to accomplish SIPA's goal of a ratable distribution among customers.

Furthermore, 2(c)(3) allows a trustee to recover voided or avoidable transfers without reference to the trustee having to show lack of good faith. In short, to the extent that SIPA modifies fraudulent conveyance actions, it expands the trustee's right of recovery in order to ensure that

fraudulent conveyance actions fit within the securities context. It does not constrict the trustee's ability to recover from customers. Thank you.

THE COURT: Thank you very much. Let me hear from counsel for the defendant.

MR. DUFFY: Thank your Honor. Todd Duffy for the initial transferees, your Honor.

THE COURT: Yes.

MR. DUFFY: We won't prolong anything more on the standard.

THE COURT: Let's talk about the -- not that I've decided this finally, but I have certainly given some hints as to where I am coming out. That is notwithstanding my tremendous respect and describe each time he is here for counsel for the trustee. He can you can come into my courtroom any time, but on this one you may be facing an uphill battle. You always have your appeal.

Yes, the standard is something I'm not clear about, I mean the burden, I am sorry, the burden is what I am less clear about.

MR. DUFFY: Before we go for the burden, I think one of the things we wanted to clarify, we served to clarify in our brief is what the standard is willful blindness, the question what are we willfully blind of?

If the trustee is accusing defendants of wrongfully

taking transfers from Madoff because he was running a Ponzi scheme, then the defenses would submit they needed to know -- they needed to be willfully blind that Madoff was running a Ponzi scheme. It is worthwhile to note the SEC which would have been in a similar financial position as some of my co-counsel here, also did an extensive investigation and didn't find anything.

THE COURT: That is a factual issue. We are talking now about standards and burdens, not about what the facts may or may not show.

If the Mets trial had ever gone to trial, and I'm still upset that I didn't get to hear from Sandy Koufax, there would have been the trustee proffered proof from a witness that the defendants in that case had been told by someone within their midst that she shot and had reason to believe that there was no way to account for Madoff's returns that he was purporting to realize, and that was not a witness who had been before the SEC.

So I don't think we know at this point what the proof would show in any of these cases that you're involved in till we get to the trial, if we ever get to the trial.

MR. DUFFY: Respectfully, your Honor, I disagree. A lot of the pleadings in the complaints themselves would certainly pan out to establish an affirmative defense for some of these defendants.

THE COURT: That may be true.

You would either have an individual motion to dismiss or an individual summary judgment motion perhaps, but all I'm talking about now is what I need to decide as a result of today's hearing is what the standard is and who has the burden. So it seems to be the theory here that the SEC didn't figure this out.

MR. DUFFY: Okay, your Honor, but again the second prong of that we believe is what is to be willfully blind of, we would submit to the court that what you need to be willfully blind of, if the plaintiffs are saying that we wrongfully accepted transfers from Madoff because he was running a Ponzi scheme, would be that we were willfully blind of the fact he was running a ponzi scheme and we actually knew that.

THE COURT: Now you're equating willful blindness with actually knew. Willful blindness means that there is a high probability and you purposefully turn away and say I don't want to know. It doesn't mean that you know it in the way you would know it if, for example, you had been a participant in the fraud or something like that.

MR. DUFFY: Yes, I agree. I apologize if I overstated that. We also believe that there are various actions that in taking those transfers, that the context of accepting those transfers should also be taken into consideration.

So, for example, if they took those transfers, but

they had professionals helping them with, as a custodian or administrator, then those types of things should also be taken into account because knowledge can't be the only possible factor you're evaluating when --

THE COURT: Doesn't that cut in favor of putting the burden of this defense on the defendants? They're the ones who know all of this, they know whether the advisors -- where they know this that or the other. It wouldn't be a question of what the trustee has to plead; it is a question of what you would have to plead or prove by way of an affirmative defense.

MR. DUFFY: Again, your Honor, that may or may not be true. What I would say is that the trustee still has a responsibility of proving a plausible complaint, pleading a plausible complaint under Rule 8.

THE COURT: Isn't it a question, a classic question of whether this is an affirmative defense or whether the lack of good faith is an element of the claim?

If it is an affirmative defense, which we have all the time, then the burden of an affirmative defense is usually on the defendant. So here you look at, say, 550, for example, and it says that the trustee may not recover under Section (a)(2) of this section from the transferee that takes for value including satisfaction or securing of a present or antecedent debt in good faith and without knowledge and a voidability of the transfer avoided. You look at that language and you can

read it as maybe being that the trustee has to plead an absence of that or you can read it as that's an affirmative defense. It doesn't beat out from the language which way it cuts.

The same kind of thing applies with respect to 548, although it is the language is a little bit different. Just to show you why I am not sure that they both come out the same way, Section 548 C says:

"Except to the extent that a transfer obligation voidable under this section is voidable under Section 545 -- 544, 545 or 547 such as, for example, as actual intent, a transferee of such a transfer that takes for value in good faith has a lien on or may retain any interest transferred," et cetera.

So that may be even a little bit more like an affirmative defense because it talks about the transfer, what the transferee may do. None of this is definitive from the language in the statute. The question I was trying to put to you is this: Doesn't it make sense to make this an affirmative defense because the information that would allow someone to establish good faith or lack of good faith is much more likely to be in the hands of the defendant than it is in the hands of the trustee?

MR. DUFFY: Respectfully, your Honor, I'd say no for two reasons.

THE COURT: Why?

MR. DUFFY: First of all, prior to any litigation under the federal rules of bankruptcy procedure, the trustee can collect evidence under rule 2004 which I understand was extensively done in this case. Given certainly from my clients, it was 145 page complaint which showed --

THE COURT: There are shorter ones.

MR. DUFFY: Yes, your Honor. That was chocked filled with facts, and allegedly and I am sure the trustee's counsel had some basis for making those, so I would assume that was a result of an investigation.

THE COURT: That doesn't answer the question.

The fact that they did allow an investigation and can make some assertions here cannot be what determines what should be as a matter of law the standard because there will be plenty of cases where that won't be the case.

So it has to rest on general principles and policies, not the particulars that this particular trustee may have done a more intense investigation than some trustees ordinarily would be able to do or whatever.

MR. DUFFY: I don't think that Rule 2004 is limited to some trustees or other trustees. Anybody can do pre-litigation investigation under rule 2004 as a trustee.

THE COURT: That is true.

MR. DUFFY: In which case --

THE COURT: But, but, but I come back to the question

of why doesn't it make more sense to place the burden on the transferee who will know immediately what things they can point to that will establish their good faith, all the things you were just mentioning that at best the trustee will know a fraction of the situation, but each transferee will have an intimate knowledge of what steps it took, what it knew, what it failed to do, et cetera.

So why isn't it make sense to put that burden on the transferee? By the way, there is one other possibility, which is that the transferee could make me have the burden of having the burden of going forward, and the burden would shift to the trustee as the ultimate burden. That is the way it works in criminal cases although that is largely for constitutional reasons, not applicable to a civil case.

MR. DUFFY: One thing interesting, the transferee certainly as in Bloomberg securities laws has no burden to do an inquiry at the time of the transfer. Why then would it be asserting, taking on a burden of proving that it acted in good faith?

THE COURT: The answer -- I am not saying this is the answer because I really have not decided where I come out on this question as opposed to the first question, but there are many, many places in the law, and particularly when you're dealing with super procedural or quasi-procedural matters where the person who has the close, closest proximity to the facts

has the burden. Sometimes it is just the burden of going forward, sometimes it is the ultimate burden, but that's not an unfamiliar approach of the law.

MR. DUFFY: My understanding of the bankruptcy laws with respect to 548 (c) and 550 (b) are quite different. I know my colleague will be speaking on what 550 will be. Maybe it would be best if I defer to my colleague to speak on what 550 will be.

THE COURT: Absolutely.

MR. HARRIS: Thank your Honor.

I will just address the burden of proof argument that you raised and I am going to focus on 550 (b) and regardless of whether 548 (c) is or is not an affirmative defense, there is strong reasons why 550 (b) is not an affirmative defense and the trustee should have the burden of proof on that.

You start with the general rule the Supreme Court outlined in Schaeffer, that unless there is something that Congress points to indicating otherwise, assume that the burden of proof is on the party seeking relief. That is the trustee here. The trustee hasn't pointed to anything in 550 (b) or any practicalities of litigation that would suggest that Congress intended to change that normal burden of proof. If you look at the both the text of 550 and the practicalities of what a subsequent transferee is, they strongly support you should leave the burden where it normally is, on the party seeking

relief.

550 is structured differently than 548. You start by looking at 550 (a), and it says except as otherwise provided in this section, to the extent a transfer is avoidable under other sections, then the trustee can recover. That introductory phrase is part of 550 (a) and part of a 550 (a) claim. That means if another section of 550 is triggered, you do not have a 550 (a) claim. In that way, 550 is different from 548. If you look at 548 (a)(1) --

THE COURT: So, so, if I adopt your reasoning in that regard, I would put the burden on the trustee under 550, but not put the burden on the defendant under 548?

MR. HARRIS: There is a lot of other reasons and my colleagues can tell you why even for 548, you should still leave the burden where it normally belongs on the party seeking relief, but I am trying to show you why there is additional reasons that would apply to 550 beyond those offered.

THE COURT: I thought this was your first reason.

MR. HARRIS: That is my first.

I would also look at the text not just of 550 (a)(1) which incorporates the absence of another element of 550, but if you look at 550 (b) itself, it again is worded in a way that suggests it is part of the affirmative claim itself. It talks about the trustee and it says the trustee may not recover if the conditions are met. Again in contrast, 548 (c) focuses not

on what the trustee cannot do.

THE COURT: I am not sure how much I can draw from the grammar and wording that you're referring to.

Is it not one plausible reading of Section 550 (b)(1) that when it says a transferee that takes for value, that what that means procedurally is a transferee that establishes that he takes for value, including, et cetera, all the way down to good faith.

MR. HARRIS: It could mean that. Even before you get to that sentence, the preceding part of 550 (b) tells you the trustee may not recover.

I agree it is not the clearest language out there, but to the extent it is suggesting one thing or the other, I think it is suggesting that the trustee has to show this. That is both from the language of 550 (a)(1) which says you don't even have a 550 (a)(1) claim if another section applies and the language of 550 (b) which begins by saying the trustee may not recover. Nothing in there says the transferee has to do something to prevent a recovery or retain --

THE COURT: So, so if you're right that this is more than a makeweight argument, that this is an independently meaningful argument, then it seems to me it follows a fortiori, as you would say, that under 548 the burden is on the defendant.

MR. HARRIS: I wouldn't go that far, your Honor,

because I think if you look -- there is certainly other reasons why the burden should stay where it normally stays, in the 548 (c) context. I don't claim to be --

THE COURT: I understand that, but what you're saying is -- and I think it is not without some importance -- is that the most natural way to read the language, the way this is set up in 550 is that the burden is on the trustee if he wants to recover, to show an absence of good faith, et cetera.

But the very language analysis that you're using, then it applied equally to 548 comes out the other way.

MR. HARRIS: I am not sure it comes out the other way, but it is certainly silent.

THE COURT: In 548, they carve out, they say in (a)(1) what the trustee has to show, and then they, in (c), the subject of the sentence in (c) is the transferee or obligee, not the -- I mean the transferee or obligee, not the trustee.

Here's what the transferee or obligee has to do: Show -- now, of course, I am imputing language, but anyway, has to show that it takes for value, et cetera, et cetera.

Why I am raising all of this is one I think should pause before thinking that the grammar of these sections, and the way they were sort of written in the way we are talking about now is really that important determining where the burden lies.

MR. HARRIS: Maybe I should move on to some other

points beside the grammar of the section.

THE COURT: Go ahead.

MR. HARRIS: An additional reason why it makes practical sense here to have the trustee have the burden of proof for a subsequent transferee is because they're further removed from the debtor. Courts have noted that, and this is from the Brestman case, a subsequent transferee is much more likely to be an innocent third party. That is a reason, given it is very unlikely the subsequent transferee is actually going to lack good faith, it is inefficient and unfair for a subsequent transferee to have to go through the expense and burden of discovery and then summary judgment in order to finally show what you expect would normally be the case, that they lack -- they, in fact, operate in good faith.

Instead it makes much more sense at least for a subsequent transferee for them only to have to bear this burden if the plaintiff can't at least allege facts that if true would show bad faith.

Given the practical reality that normally a subsequent transferee is going to be in good faith, it doesn't make sense to put them through this effort, this effort we are sort of sitting in this room here now. If you look at the legislative commentary on 550 (b), it is admittedly very thin but the extent it exists, it suggests the reason 550 (b) was created, and from the House report, was created to avoid litigation for

subsequent transferees. That is only accomplished if this element is actually part of the claim.

Making an affirmative defense doesn't help you avoid litigation. There is also as you know cases going both ways on this point, obviously.

What I would say --

THE COURT: I found that very helpful.

MR. HARRIS: I did my best to go through the cases that the trustee and SIPIC pointed to, and I don't think any of them have any analysis why 550 (b) should be an affirmative defense except for one and that is the Nordik Village case. In the Nordik Village case, the majority analysis was I believe a flawed analogy to Section 549 where, in fact, it is an affirmative defense.

The reason why the analogy is flawed, for Section 449 there is actually a bankruptcy rule, Rule 6001 that changes the burden of proof to turn it into affirmative defense. There is no such rule for 550 (b). I think that lack is important. Now Justice Kennedy's dissent points that out, as the Third Circuit did in Brisnan, and pointed out the practical point I alluded to earlier because of subsequent transferee is normally in good faith, it doesn't make sense to impose this as an affirmative defense on them.

So there are certainly cases going both ways. If you look at the text of the statute, to the extent it informs

anything, and if you look at the reality of the subsequent transferee, they're much more likely to be innocent. There is not a reason to change the normal rule, just the burden of proof is on the party seeking relief.

THE COURT: Thank you very much. Is there anyone else who wants --

MR. DUFFY: May I add one other thing?

THE COURT: Yes.

MR. DUFFY: In this case, since we have already established there is no duty at least preliminarily to investigate on behalf of the defendants, if you acted just by simply withdrawing your money from your redemptions, it is almost presumed you did do it in good faith. Possibly the burden doesn't rest entirely on the trustee, but it may be a shifting burden, in which case it is extremely difficult for a defendant to prove a negative. So that makes the burden that much higher for a defendant to basically approach this in a vacuum.

THE COURT: All right. Thank you. Let me hear from anyone else on the defense side who wants to be heard from?

MR. WILES: I have a few points I would like to make.

Your Honor, first on the idea that we're talk about here is just a matter of equities over who has a better equitable claim to property, that is not what a fraudulent transfer claim is. We're talking here about an intent to

defraud and/or delay creditors. We are talking about a statute that is follow-up on the common law that is meant to address a very specific kind of wrongdoing, and by referring to good faith, it is meant to apply a remedy only to people who are culpable in that wrongdoing. That is why you have a defense of good faith. That is why the claim is limited to an intentional fraud. We are not talking here about preferences or any kind of general equity notion. We are talking about specific kind of wrongdoing.

THE COURT: Obviously, I am predisposed towards that argument, as you may gather from my comments earlier, but your adversary in effect is arguing among other things that the bankruptcy code changed that. It created presumptions, it created modes of addressing these difficult situations that were different from the common law.

So what about that?

MR. WILES: Well, yeah, I am getting to the burden.

I agree with you there is nothing about the wording of this statute that you can say one way or the other is very clear as to whether it is the trustee's burden or the defendant's burden. It doesn't say, for example, that a defendant can avoid liability by proving, et cetera, okay?

I think what you have to do is you have to think about the nature of the claim and the wrong in deciding what needs to be alleged here. Also to keep in mind that who has the burden

of proof depending on what the issue is not necessarily the same as who has the initial burden of raising a plausible issue about the point.

The reason I made the other point about this being a liability for a particular kind of wrong is that you really can't consider the wrong and the good faith issue apart from each other. That is really the whole point here is that unless you have some culpability for the underlying wrong that is being addressed, you're okay.

Now, if you think about it, what about from the trustee's point of view? Here I am, my client FEMA is a net loser, never withdrew more than its initial withdrawals. Now, if the rule is, as I think it should be, that in pleading this claim of intentional fraud, the trustee has to plead not only that Madoff in the transfers he made to me somehow was intending to defraud other people, which I question, but also some plausible connection as to my lack of good faith that is connected to that wrong.

Well, what the trustee alleges, as he has in his papers, that the reason that was a wrong is that it allowed FEMA to do better than other customers could do. Great, I know what the issue is, I can come into you, I can say, your Honor, I know you're a big fan of Learned Hand. You look at the Irving Trust decision from 1933 where Judge Hand was on the panel, 65 F.2d 409, it couldn't be clearer. It addresses

exactly this point, neither an intent by Madoff to confer a preference or my intent to receive one or knowledge it was going to happen is enough to establish a fraudulent transfer claim and I can make a motion to dismiss.

Great. At least the trustee in that context has framed the issue and has at least told me why is there some point that I need to defend here?

If you take the point of view argued by the trustee in SIPIC, where all they have to say is that Madoff had a bad state of mind, and I don't know how the fact that he was running a fraud necessarily translates to a fraudulent intent in making a transfer to me, by the way, but if that is all they need to say and everything else is may burden, I don't even know how to contest that. I don't know what I need to prove. How can I even sustain that? How can I litigate the issue?

I don't each know in what respect good faith is relevant. That does not make sense. It especially does not make sense for a trustee in a proceeding meant to protect victims like me, to say that all I need to do is to say Madoff was bad and the presumption is that you were bad, too, until you prove otherwise, and I am not going to tell you or give you a clue what it is I think you need to prove in order to show you weren't a bad guy. That is insane. It doesn't make any sense as a way of proceeding.

On the theory only a few people have been singled out

for the joy of having to prove their good faith, it may be true that in terms of numbers of Madoff customers, if that is the case, I don't know how many individual customers he had, but only the trustee knows. I would bet you that the trustee in terms of dollar amount of contributions to Madoff, that the trustee has accused at least 90 percent of the dollar amount of investors or withdrawals or lack of good faith.

So what you've got here, if you accept the trustee's and SIPIC's point of view, the trustee, whose job is to protect these investors, by the way, and SIPIC, who is supposed to be their insurer and their guardian, are perfectly entitled, almost even required to walk in and to say, to demonize every single one of those villains and say you are presumed to be bad till you can prove otherwise.

That should never be the standard in a SIPIC case. We are wasting huge amounts of money here and will be forced to waste even huger amounts of money if we have to wait until we're standing in front of a jury before we even know how are we accused of being in bad faith so that we can prove otherwise. That makes no sense as a way of proceeding for anybody. I have two other points I wanted to make.

Mr. Duffy was talking about in terms of the willful blindness standard, it is not enough to know how you measure knowledge. You have to be asking what is it I'm supposed to know of. The point that I think to be made there is the

trustee argues that there is any irregularity, there is knowledge of insolvency, if there is a suspicion, if a wrong date is put on a trade, for trying out loud.

If what I am being accused of is lack of good faith for taking the fruits of a Ponzi scheme, which is what they say over and over in their papers, well then what I should be accused of being willfully blind of in order to show lack of good faith is that I knew it was a Ponzi scheme.

If the reason you're going to tag me --

THE COURT: Part of this, you are perfectly right that the two issues of the standard and the burden are somewhat intertwined, but I think you're being a little unfair. The trustee premised his complaints on his view, which I am expressing a lot of skepticism about, but on his view what was triggered was a duty to inquire.

And there were enough suspicious circumstances for people like your clients at that time they then had a duty, he says, to turn around and make inquiries and -- so you do know what he is accusing of you under his theory. The point you're making, which I think s much to commend it, is that if instead the standard is the one that you're espousing, willful blindness, then his complaints don't really tell you what it is that you did wrong because then there is no duty of inquiry.

Rather it is the allegation has to be that you knew this was a fraud or you knew -- excuse me -- you knew there was

a high probability it was a fraud and then turned away rather than find outing for sure.

MR. WILES: Right. One other point?

THE COURT: Go ahead.

MR. WILES: In addition to how you measure knowledge, what is it you need to know? Knowledge isn't the only answer here. We keep talking about knowledge as though we are only talking about it at the time of the investment. That is not what the trustee is claiming.

He is claiming that people who had no idea what was going on, but who should have learned afterwards that there was something wrong, that it was a lack of good faith for those people to take their money out. That doesn't make any sense.

If you're a fraud victim and you discover you're a fraud victim, it can't be the case that good faith requires you to leave your money in the hands of the guy who is conducting the fraud. How can that possibly be the answer?

So in addition to how you measure knowledge, what is it you need to know about? You have to think about well even if you know --

THE COURT: No, I think that is a little unfair to the trustee. His argument, as I understand it, is it is not that you should not take or it is not that you should give it back to the fraudster, it is that you now take with the, in effect, qualification that someone who is recovering on behalf of the

estate as a whole may have a better claim to those monies than you do, that that is what his argument is on this point.

MR. WILES: What he is saying, it is bad faith to take the money, that is what he is saying. I don't know how you, how you equate that with anything other than that good faith somehow requires you to just sit there, not take your money and let things go on.

The irony of this, what the trustee says --

THE COURT: No, no. Maybe I am not hearing the answer to my question. This is not a perfect analogy at all, but you see $100.00 bill lying there on the couch. You believe that it has been abandoned and you can take it as the first finder, but then before you're about to take it, you become aware that someone is claiming that it was stolen from them.

Well, you may still take it because it may turn out that that person is just making it up or there is no basis to believe it, but you have a realization that you may not keep that hundred dollars forever. Someone may come after you representing that guy who said it was stolen from him and say hey, you sort of knew that or there was reason that you had to believe that.

So I think that's -- the trustee can speak for himself, but I think that is the argument he is making.

MR. WILES: Let me clarify what I am trying to say.

If you're talking about I took a briefcase that had

your Honor's name on it, all right, I understand the point and talking about stolen property. Stolen property, as the words are tossed around occasionally in this case, are an analogy, not a description of what happened because none of the assets that Madoff had, and he had million of dollars at all times, it wasn't like there were dollars that had individual customer's names on them.

The trustee in SIPIC both acknowledge my clients had just as much right to what Madoff had as what anybody else had. We're not talking about stolen property. We are talking about, as becomes clear in their briefs, whether a preference was obtained, whether when my customers who were net, my clients who were net losers, when they obtained withdrawals, the trustee says you did better than other people.

Well, if you're a creditor and you think somebody is committing fraud, that is exactly what you're supposed to do. You're supposed to go in and get your money back. To argue that you are somehow acting in bad faith for doing so just because there are other potential victims is just wrong. The Sharp case says that is wrong. All the other cases that we have cited you say that is wrong.

The cases have recognized for years that if you're a creditor entitled to collect a debt, you have a purpose of your own to serve. If that is all you do, you have acted in good faith. You have only acted with a lack of good faith if you do

something else to assist the debtor in defrauding other creditors.

If you know that you're getting a preference, that is all you know, that is not a lack of bad faith. That is exactly what the Irving Trust decision says, exactly what the Sharp decision says, both Second Circuit decisions. They couldn't be clearer.

THE COURT: Thank you very much. Who else wants to be heard?

MR. LIPSCHITZ: I have two mall points on behalf of the leverage providers.

As your Honor knows, as we made clear in our briefs, none of the leverage providers, none of the allegations in the complaints against the leverage providers come anywhere close to alleging that any of the leverage providers had acted with willful blindness or reached a subjective judgment, as your Honor described earlier, of a high probability that Madoff was running a Ponzi scheme.

That is not an accident because the allegations in the complaint make it clear why it is implausible than any leverage provider would provide leverage with the subjective belief that Madoff was running a Ponzi scheme. The way these transactions work and as is alleged in the complaint, is that none of the leverage providers stood to benefit from any appreciations of the feeder funds to which they permitted third parties to get

leverage in making their investments.

The only benefit that the leverage providers are alleged to have received are the small feeds associated with these transactions. It is simply implausible that they then hedge the leverage they provided by becoming investors in these feeder funds. As a result, because they were perfectly hedged, and that is what is alleged in the complaints, whether the feeder fund appreciated in value, they would not have benefited from that appreciation.

It seems, on the other hand, if the funds declined in value, they would lose the amount of leverage that they provided. It is simply implausible that in an effort to make a small, nominal interest rate, which is what the leverage providers benefited from, they would have put hundreds of millions of dollars at risk, which is in fact what happened in most if not all of the leverage providers are not losers who lose hundreds of millions of dollars.

The second point is that in this particular case, the complaints also establish value, something that we explained in our briefs and something which is not responded to in either SIPIC's opposition. In fact, if there is anything to be said there, they concede to the extent that the money that the leverage providers drew back was principal, they haven't established value. For those reasons, the complaint against the leverage providers should be dismissed.

THE COURT: Thank you very much. Anyone else want to be heard on the defense side?

Okay. Let me hear a final word from the trustee.

MR. WARSHAVSKY: Unfortunately, more than one word.

I think I would start, your Honor, just by -- I know in the order, when we submitted the order to your Honor, we were clear on this. To the extent that this is now a motion to dismiss, we would ask for the right to replead because to an extent the standard has been changed.

THE COURT: Yes, yes, totally right.

MR. WARSHAVSKY: Going to just a few points, Mr. Wiles discussed it, a client becoming aware of a fraud, when it became aware and pulled out, these are inherently factual issues. I don't think any of that was anything we dealt with in the complaints. I think the scenario that he provided to you is a pure hypothetical. I don't believe that any of our complaints talk about somebody discovering a fraud, not knowing it was a fraud, discovering it was a fraud and pulling all their money out. I am may be wrong.

THE COURT: No, because you thought the standard was different.

MR. WARSHAVSKY: Right.

THE COURT: I understand that completely. That is, among other reasons, why under any set of circumstances it would be imperative that you be given an opportunity to

replead.

If you had a good-faith basis for believing the standard was X when you filed your complaints, and the court determines that the other standard is Y, then if you can, you should be given the opportunity to replead to Y. You may not have the facts that would warrant your repleading to Y. That is a different question.

MR. WARSHAVSKY: That is when I get back to the pleading standard. The trustee comes in as a stranger to this. That is I think why the bankruptcy code is set up the way that it is.

Your Honor read from 548, and I think 548 is clear because it starts with the presumption that the trustee can recover, and when you look to 548 (c), it talks about except to the extent a transfer is under the other sections, where the transferee wouldn't have this defense, in particular look at 547 which is a preference statute, all right, and there good faith or value doesn't matter for preference. Preference, the trustee just has the option to pull back.

A trustee might know the value component ahead of time but may not as well. Here where there are books and records that a trustee can work from, a trustee may be able to. In a situation where Mr. Madoff did, for instance, transfer out a ring or something like that, the trustee wouldn't know what the value is until after the complaint. The defendant would have

to come forward and show value.

Likewise, good faith, the trustee certainly has alleged facts. We believe that is above and beyond what the trustee last to allege, what a trustee in bankruptcy would, and as the trustee comes in as a stranger in the relationship between the parties.

I would then turn to 550 because we spoke about burden. It is important to remember 550 is a recovery statute, and my adversary read from 550. 550 covers both initial transfers and subsequent transfers. 550 (a)(1) talks about the initial transferee.

THE COURT: You're saying it would be kind of strange to say that the burden should go one way under 550 (a)(1) and the other way 550, really would be under (b), but the burden should turn on whether it is an initial or subsequent transferee when they're both, so far as 550 is concerned, glommed together.

MR. WARSHAVSKY: Correct. That is because it is a recovery statute, and if we look to 550 (b), 550 (b) actually has three components, and I know we discussed it in our paper.

The first component, value, which is not an issue for today. The second component, good faith. The third component is without knowledge of the voidability of the transfer avoiding. How could a trustee ever know that a defendant, unless a defendant is stupid enough to publicize ahead of time,

hey, I think the debtor is about to go insolvent, I'm going to try and collect money, how would a trustee ever know that ahead time? How could a trustee ever meet that standard ahead of time?

(Continued on next page)

The recovery is presumed unless the defendant can come back with the value component, the good faith component, and without knowledge. That conjunction there means that all three of those conditions must be met for the transfer not to be avoided, for that property not to be recovered.

THE COURT: Let me make sure how this plays out.

MR. WARSHAVSKY: Sure.

THE COURT: You bring a claim under 550. Under your view that the burden is on the defendant to raise good faith as a defense, they put in an affidavit saying, we had no knowledge of any fraud, there was nothing about the situation that ever led us to believe there was a fraud, we didn't know X, we didn't know Y, we didn't know Z. You come back and say, well, we have evidence that they did know X or Y or Z or at least knew there was a high probability of it, here's our evidence.

I understand your argument for saying they should have the burden of going forward, which is the way I just described it. But now they've gone forward and produced an affidavit and maybe records and other things, all of which show that as far as they were concerned, this had all the indicia of an innocent transfer, without any knowledge of anything wrongful on the part of the transferor. You have come back with evidence that they did have such knowledge.

Now the case goes to trial. Who bears the ultimate burden on this issue, on the good faith issue? Is it their

burden to establish that they acted in good faith? Is it your burden to establish that they failed to act in good faith? All the discussion this evening has largely turned on who would have the initial reason to go forward. OK, that maybe just relates to the burden of going forward.

Now we are talking about the burden on the merits. Who has that? The arguments you're making, and frankly the arguments they were making, don't seem to me to answer that one way or the other.

MR. WARSHAVSKY: I think that the statute talks about good faith. I can tell you that we wouldn't take a case to trial if we were going to allege that the defendant acted in good faith. I think that the defendant has to come forward and present credible evidence, whether at summary judgment --

THE COURT: Typically spoken of when we are talking about a burden of going forward, they have to put up prima facie evidence of it. Despite all the stuff I heard from their side about how difficult that would be, actually I think it would be very easy. Sure, it would be asserting negatives, but they are the negatives that any innocent person would find easy to assert: I had no knowledge of anything improper, I wasn't on notice, blah-blah-blah. Now they have satisfied the burden of going forward because they have presented through a sworn affidavit a prima facie case of their good faith.

MR. WARSHAVSKY: That's right.

THE COURT: Now we go to trial. I thought one of the strongest arguments they made is that in the default position as to an element of the claim, it is on the plaintiff.

MR. WARSHAVSKY: Correct.

THE COURT: Now shouldn't it be the plaintiff's obligation to show that they lack good faith?

MR. WARSHAVSKY: If it were an element of the claim, I don't think I could come to a different result. Our position has been an affirmative defense and that the defendants would have the burden at the beginning, and then it is up to the plaintiff to rebut that.

THE COURT: Why should it be considered an affirmative defense in the way you're talking about? Of course, to call it an affirmative defense is to beg the question.

MR. WARSHAVSKY: Right.

THE COURT: They are asserting good faith. Why isn't it natural, if you're disputing that, for you to have the burden of saying, baloney, here is the proof that they had fraudulent knowledge or were willfully blind or whatever?

MR. WARSHAVSKY: I think the answer to that is because -- you're right, it is somewhat of a tautology for me to come back and say it is an affirmative defense. I understand that. But the statute speaks in terms of good faith. I think ultimately if the statute said that it was bad faith, perhaps that would be the trustee's burden to prove bad

faith.

THE COURT: They would respond, at least as to 550, and say the language of the statute is the trustee may not recover from a transferee who takes in good faith. That introduces some ambiguity into the way you're approaching it.

MR. WARSHAVSKY: Except remember this is a recovery statute. It's a recovery statute. The trustee comes with the fact that this is already established as property of the estate. The defendants are in possession of the property and want to keep it. Therefore, I think that is why it is their burden to show that --

THE COURT: That is the argument you started with an hour ago.

MR. WARSHAVSKY: At least I'm consistent.

THE COURT: It's not a frivolous argument. I just wanted to explore it all a little bit more.

I will take this matter under advisement. I thank all counsel for excellent arguments.

MR. WARSHAVSKY: Your Honor, I'm sorry. If I could make one other point because I didn't get to make it earlier?

THE COURT: Go ahead, yes.

MR. WARSHAVSKY: I did talk earlier about and I did want to bring your attention to 550. It is in our papers, but I would be remiss if I didn't raise it here again.

Congress does say in 550(b)(1) there is a knowledge

component. If the defendants' interpretation of what good faith or lack of good faith is, these two pieces, in good faith and without knowledge of the voidability of the transfer, would ultimately be the same thing; you would have to read the statute as being redundant.

MR. HARRIS: Your Honor, could I be heard very briefly just on that point?

THE COURT: Sure.

MR. HARRIS: Chris Harris. I think the cases and the commentary are pretty persuasive and overwhelming that in fact the knowledge prong is an illustration of what lack of good faith means. Every case that has analyzed this has said this. The trustee doesn't cite any cases that say in fact they mean something different. The committee that recommended these changes said it was an illustration of what good faith meant. Collier's, when it summarizes the case law, says the same thing. So I don't think this changes the analysis at all.

It is true that knowledge and good faith might be more in the hands of a subsequent transferee than in the hands of the trustee, but that doesn't end the inquiry. There are lots of kinds of claims where a plaintiff has the burden of proof on the state of mind of the defendant, such as the securities laws.

The mere fact that we have an illustration of what good faith means and that lack of good faith would mean

knowledge of the voidability, that doesn't change the analysis here. They still haven't articulated a reason why it makes sense to make a subsequent transferee who is presumed to be innocent go through the burden of all this, going through new discovery, before it can finally get out of this case.

THE COURT: I need to go back and look at more of the legislative history. I thought Congress was making a distinction here. Without knowledge of the voidability of the transfer avoided refers to one specific kind, this may be your point, one specific kind of good faith, but good faith encompasses a lot more. This is not the only form that good faith can take.

MR. HARRIS: That is a much better way of articulating what I meant to say. It's an illustration of what lack of good faith would be.

THE COURT: Go ahead.

MR. WARSHAVSKY: Your Honor, I will go back to the plain meaning of the statute. There is a conjunction here. There is nothing that says "for example." This is a tripartite test. The fact of the matter is the defendants did cite one case where it was treated similarly, I will grant you that. We cited cases as well.

However, the plain meaning, if nothing else, these arguments with you have been clear about is your notice and your articulation of the trend to look at the plain language.

Nothing can be plainer here than that there are three requirements for a subsequent transferee to keep that transfer. That is value, good faith, and a lack of knowledge of the voidability of the transfer.

THE COURT: All right. Those are all good points from both sides. I will have to figure that one out, too. Again I thank all counsel. This matter is adjourned.

(Adjourned)